



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date:	07/02/14	Bill No:	Assembly Bill 2372
Tax Program:	Property	Author:	Ammiano and Bocanegra
Sponsor:	Author	Code Sections:	RTC 64, 480.1, 480.2, 480.9, 482, 486
Related Bills:		Effective Date:	Upon enactment

BILL SUMMARY

This bill creates a new “change in ownership” event for legal entity owned real property that occurs whenever 90% or more of the direct or indirect ownership interests in that legal entity are cumulatively transferred.

Specifically, this bill:

- On or after January 1, 2015, requires reassessment of a legal entity’s real property holdings whenever 90% or more of its ownership interests cumulatively transfer. §64(c)(1)(B)
- Excludes publicly traded corporate stock or partnership interest sales occurring in regular trading activity on an established securities market. §64(c)(1)(B)(ii)(VI)
- Requires the change in ownership event to be reported to the Board of Equalization (BOE) within 90 days. §§480.1, 480.2, 482
- Increases the penalty from 10% to 15% for failure to report legal entity reassessment events to the BOE. §§480.1, 480.2, 482
- Requires the BOE to notify assessors when legal entity reassessment events occur. §480.9
- Requires the BOE to report the reassessments occurring under the new trigger event and their revenue impact by 2020. §486

Summary of Amendments

Since the prior analysis, the bill has been amended to (1) eliminate the 36-month limitation, making the 90% or more ownership interest threshold open-ended, (2) include direct and indirect transfers and address indirect ownership, (3) specify the reassessment date, (4) clarify that the BOE is to report on the revenue impact, and (5) make technical amendments noted in the prior BOE analysis.

ANALYSIS

CURRENT LAW

Change in Ownership. When a “change in ownership” occurs, the law requires the assessor to reassess the property to its current fair market value¹. Different laws apply to a person who buys real estate and a person who buys a legal entity that owns real estate.

Interests in Real Property. Revenue and Taxation Code Section 61(j) provides that a change in ownership includes the transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner or any other person.

¹ California Constitution Article XIII A, Sec. 2; Revenue and Taxation Code Sections 60 - 69.5

As a general rule, the law requires a reassessment equal to the percentage interest transferred.

Interests in Legal Entities. Section 64 sets forth the change in ownership provisions for the purchase or transfer of ownership interests (e.g., stock in a corporation, interests in a limited liability company, or interests in a partnership) in legal entities that own real property. As a general rule, under Section 64(a), transfers of ownership interests in legal entities do not constitute a change in ownership (and, therefore, no reassessment) of the legal entity's real property. However, there are two exceptions to the general rule as follows:

- **Change in Legal Entity Control.** Section 64(c)(1) requires reassessment when any person or entity obtains control through direct or indirect ownership or control, of more than 50% of corporation voting stock, or obtains more than a 50% ownership interest in any other type of legal entity. The reassessment covers all real property owned by the acquired legal entity (and any entity under its control).
- **Cumulative Transfers by “Original Co-owners.”**² Section 64(d) requires reassessment when voting stock or other ownership interests representing cumulatively more than 50% of the total interests in a legal entity are transferred by any of the “original co-owners” in one or more transactions. The reassessment covers the real property previously excluded from change in ownership under Section 62(a)(2).

Existing statutes do not specify the method of counting indirect ownership of legal entity ownership interests.

Self-Reporting Requirement. Existing law requires legal entities to file a change in ownership statement (LEOP COS³) with the BOE within 90 days of a change in control or change in ownership under Section 64(c) or (d). In the case of a change in control under Section 64(c), the person or legal entity that *acquired* control of the legal entity is responsible for filing the LEOP COS. A penalty applies if it is not filed within 90 days. The penalty amount is 10% of the taxes applicable to the new base year value reflecting the change in control or change in ownership of the real property owned by the legal entity.

Requirement to File Upon Request. The BOE searches for unreported changes in control and ownership of legal entities under Section 64(c) and (d). Annually, the BOE canvasses legal entities with a query on the state income tax return. Additionally, the BOE monitors business publications. Assessors and other interested parties also send referrals reporting possible changes. Using these leads, the BOE sends a LEOP COS to the entity to complete and file with the BOE. A legal entity that fails to respond may incur a penalty.

PROPOSED LAW

Transfers of Ownership Interests in Legal Entities: Change in Ownership Trigger Event. This bill provides that whenever 90% or more of the direct or indirect ownership interests in a legal entity are cumulatively transferred in one or more transactions, the transfer

² **Proportional Ownership Interests Exclusion Creates “Original Co-owner” Designation.** Under Section 62(a)(2), a transfer of real property to a legal entity does not result in a reassessment if the transfer is merely a change in the method of holding title and the proportional ownership interests in the real property are *exactly* the same before and after the transfer. However, after a transfer of real property qualifies for this exclusion from reassessment, the persons holding ownership interests in the legal entity immediately after the transfer are considered “**original co-owners**” for purposes of tracking subsequent transfers by original co-owners of those interests. When such transfers cumulatively exceed 50%, the real property previously excluded from reassessment under Section 62(a)(2), is deemed to undergo a change in ownership, and is, therefore, subject to reassessment under Section 64(d).

³ Legal Entity Ownership Program (LEOP) Change of Ownership (COS) detailed on page 6 of this analysis.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

of the ownership interests is a change of ownership of the real property the legal entity owns, including the real property owned by a legal entity under its control. A change in ownership triggers reassessment. §64(c)(1)(B)

“**Control**” means control as described in §64(c)(1)(A) – i.e., obtaining control through direct or indirect ownership or control of more than 50% of the ownership interests. §64(1)(B)(ii)(I)

Once an ownership interest transfer counts towards a transaction that triggers reassessment, that interest may not be counted again. §64(c)(1)(B)(ii)(V)

Ownership attribution. For purposes of Section 64, legal entity ownership interests owned by a legal entity will be considered as being owned by, or transferred to, its owners proportionately. §64(g)

Means of transfer. The reassessment trigger applies regardless of how the ownership interest transfer occurs. Specifically noted transfer methods include mergers, private equity buyouts, and ownership transfer from one financial institution to another. *Section 1*

No control standard. Unlike existing law, under the new reassessment trigger it is immaterial whether or not any one legal entity or person acquires more than 50% of the ownership interests. §64(c)(1)(B)

Securities market trades excluded. A transfer does not include a sale of stock or interests in publicly traded corporations or publicly traded partnerships in the regular course of a trading activity on an established securities market. However, this exclusion is inapplicable if the shares are acquired as part of a merger, acquisition, private equity buyout, transfer of partnership shares, or any other means that otherwise triggers the new reassessment provision. §64(c)(1)(B)(ii)(VI)

“**Legal entity**” means a corporation, a partnership, a limited liability company, or other legal entity. §64(c)(1)(B)(ii)(II)

“**Ownership interests**” means corporate voting stock, partnership capital and profits interests, limited liability company membership interests, and other ownership interests in legal entities. §64(c)(1)(B)(ii)(III)

Regulations. Authorizes the BOE to prescribe any needed regulations. §64(f)

LEOP COS. Related to the LEOP COS required to be filed with the BOE, this bill:

- **Increases Penalty.** Increases the penalty from 10% to 15% for failure to file a LEOP COS with the BOE. §§480.1, 480.2, 482
- **Filing Responsibility.** Specifies that in the case of a change in control [Section 64(c)(1)(A)] the person or legal entity acquiring control is responsible for filing the LEOP COS. Specifies that in the case of a change in ownership [Section 64(c)(1)(B)], the legal entity that underwent the change in ownership is responsible for filing the LEOP COS.
- **FTB Questions.** Modifies the questions placed on franchise income tax returns to address the new change in ownership event.
- **Requires Assessor Notification.** Requires the BOE to notify assessors if a change in ownership occurs as described by new Section 64(c)(1)(B) or existing Section 64(c). §480.9

Effective Immediately. This bill takes immediate effect, but applies only to transfers that first occur on or after January 1, 2015.

IN GENERAL

Property Tax System. In 1978 voters changed California's property tax system with the approval of Proposition 13. Under this system, a property's assessed value is based on its 1975 fair market value until the property changes ownership. Thereafter, annual assessed value increases are limited to 2% or the inflation rate, whichever is less. When the property changes ownership, it is reassessed to its current market value and future increases to that value are subject to the same limits.

Change in Ownership. While Proposition 13 provided a "change in ownership" reassessment trigger, it did not define this key phrase. The Assembly Revenue and Taxation Committee appointed a special Task Force to recommend the statutory implementation for Proposition 13 and define change in ownership. The Task Force consisted of 35 members, including legislative and BOE staff, county assessors, public and private sector attorneys, and trade associations.

The Task Force published its findings in **Report of the Task Force on Property Tax Administration**, California State Assembly Publication 723, January 22, 1979. The Assembly Revenue and Taxation Committee also published a report that contains additional background on defining change in ownership called **Implementation of Proposition 13, Volume 1, Property Tax Assessment**, California State Assembly Publication 748, October 29, 1979.

Property Owned by Legal Entities. One issue the Task Force faced was how to apply Proposition 13's change in ownership provisions to property owned by a legal entity. For instance, would a transfer of ownership interests in a legal entity that owns real property be considered a transfer of the real property interests and, thus, a change in ownership? The Task Force considered two alternatives: the "separate entity theory" and the "ultimate control theory."

- **Separate Entity Theory.** The separate entity theory respects the separate identity of the legal entity. Accordingly, as long as the legal entity owns the property it will not be reassessed, even if all of the ownership interests in the legal entity transfer.
- **Ultimate Control Theory.** The ultimate control theory looks through the legal entity to determine who holds the ownership interests and, thus, who has "ultimate control" of the legal entity. Under this theory, real property owned by the legal entity is reassessed only when a single holder of ownership interests gains control of the legal entity through the acquisition of a majority of the ownership interests.

The Task Force recommended the separate entity theory be adopted for two reasons. The Report states:

(a) The administrative and enforcement problems of the ultimate control approach are monumental. How is the assessor to learn when ultimate control of a corporation or partnership has changed? Moreover, when the rules are spelled out (and the Task Force actually drafted ultimate control statutes) it became apparent that, without trying to cheat, many taxpayers, as well as assessors, would simply not know that a change in ownership occurred. The separate entity approach is vastly simpler for taxpayers and assessors to understand, apply, and enforce. Transfers between individuals and entities, or among entities, will generally be recorded. Even if unrecorded the real property will have to be transferred (by unrecorded deed or contract of sale, for example). Taxpayers can justifiably be expected to understand that a transfer of real property is a change in ownership and must be reported to the assessor.

(b) The ripple effects of ignoring the general separate entity laws of the state could not be predicted. The ultimate control theory threatened unknown disruptions of business organizations and practices. The separate entity approach avoids that pitfall by adopting the existing structure of corporate, partnership, etc. laws and building upon them.

In 1979, the initially codified change in ownership definitions for ownership interests in legal entities were based on the separate entity theory, as recommended by the Task Force. However, thereafter, subdivision (c) of Section 64 was added to provide that a change in ownership occurs whenever there is a change in control by a transfer (or transfers) of more than 50% of the total ownership interests to a single person or entity.

According to the Assembly Revenue and Taxation Committee's **Implementation of Proposition 13**, subdivision (c) of Section 64, "the majority-takeover-of-corporate stock" provision was added "out of a concern that, given the lower turnover rate of corporate property, mergers or other transfer of majority controlling ownership should result in a reappraisal of the corporation's property - an effort to maintain some parity with the increasing relative tax burden of residential property statewide, due to more rapid turnover of homes. It was also a trade-off for exempting certain transfers among 100% wholly-owned corporations⁴."

Tax Burden. The Task Force expressed concern that a tax burden shift to residential taxpayers could occur under its separate entity theory since commercial and industrial property changes ownership less frequently than residential property. The definitions originally proposed for legal entities using the separate entity theory were chosen to mitigate administrative difficulties. Because of this concern, the Task Force proposed that the Legislature study the idea of a constitutional amendment to periodically appraise commercial and industrial property at current market value noting:

[s]uch a constitutional change would also result in far greater simplicity in the treatment of legal entities. If commercial and industrial properties were to be periodically reappraised for reasons other than change in ownership, the difficult and controversial policy issues in choosing between the 'ultimate control' approach or 'separate entity' approach, outlined previously, would largely be avoided. The Task Force commends the principle of such a change to the Legislature for additional study.

Change in Ownership Tracking. Revenue and Taxation Code Section 255.7 requires the county recorder to provide the assessor with a copy of an ownership transfer document as soon as possible when a change in ownership is recorded. Assessors discover most changes in ownership of real property via grant deeds or other documents recorded with the county recorder. However, real property owned by a legal entity may undergo a "change in ownership" with no grant deed or other document recorded that could alert the assessor to a reassessment. Reporting of these types of changes in ownership is self-reported by the entity involved directly to the BOE.

LEOP. As noted previously, it is difficult for property tax administrators to independently discover reassessable events involving legal entities because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity. Because of these difficulties, the law requires the BOE to participate in the discovery of changes in ownership

⁴ Section 64(b) excludes transfers of ownership interests between affiliated corporations and Section 62(a)(2) excludes transfers which result in a change in the method of holding title to real property while the proportional ownership interests remain unchanged.

and changes in control of legal entities under Section 64(c) and (d)⁵.

The BOE participates in this discovery through a program called the Legal Entity Ownership Program (LEOP). Under the LEOP, which started in January 1983, the BOE:

- Receives a list of legal entities from the Franchise Tax Board (FTB) that have reported a change in control or change in ownership on their income tax returns.
- Monitors business publications, such as *Mergers & Acquisitions* and the Wall Street Journal.
- Receives referrals from assessors as a result of information obtained in local publications or business property statement filings.
- Sends a LEOP COS called the “Statement of Change in Control or Ownership of Legal Entities” to each entity that might have experienced a change in control or ownership.
- Analyzes completed LEOP COS’s to determine whether there has been a change in control or ownership.
- Notifies county assessors of changes in control and ownership.

Annual Canvassing. Section 64(e) requires an annual canvassing of legal entities via the state income tax return. The FTB transmits to the BOE the names and mailing addresses of the legal entities that report a change in control and/or a change in ownership on the income tax return for further investigation. The BOE makes a written request to the legal entity to file a LEOP COS to determine if it experienced a change in control or ownership or it obtained control of another entity where the entity experiencing the change owned real property in California that should be reassessed

The BOE also makes formal written requests to legal entities to investigate other possible changes in ownership based on information obtained from monitoring business publications and local assessors and interested parties referrals. Additionally, at the local level, businesses are canvassed via the annual business property statement filed with the local assessor.

Consequences of Ultimate Discovery. Generally, the statute of limitations provisions found in Section 532 limit escape assessments to either four or eight years for prior tax years. But due to concerns with intentional concealment of legal entity change in ownerships, provisions enacted in the late 1990’s removed the statute of limitations to ensure there would be no financial advantage to concealing the event. Thus, Section 532(b)(3) requires that an escape assessment be made for every tax year a legal entity fails to file the change in ownership statement, as required by Section 480.1 for a Section 64(c) change in control, or Section 480.2 for a Section 64(d) change in ownership.

Guide to Change in Ownership Reporting Statutes

RTC Section	Subject <i>Click on link to view sample forms</i>
64(e)	State Income Tax Return Questions <ul style="list-style-type: none"> • Corporate – Form 100 - Question J • Partnership – Form 565 - Question T • LLC - Form 568 - Question O • Filed with FTB • FTB transmits information to BOE

⁵ Chapter 1141 of the Statutes of 1981 (AB 152).

RTC Section	Subject <i>Click on link to view sample forms</i>
480	Change In Ownership Statement (COS) <ul style="list-style-type: none"> • Transfers of Real Property • Filed with local county assessor
480.1	LEOP COS <ul style="list-style-type: none"> • Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP) • Change In Control under §64(c) • Filed with BOE
480.2	LEOP COS <ul style="list-style-type: none"> • Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP) • Change In Ownership under §64(d) • Filed with BOE
481	COS and PCOR – Confidentiality
482	Failure to File Penalties <ul style="list-style-type: none"> • COS - §482(a) [Penalties related to §480] • LEOP COS §482(b) [Penalties related to §§480.1 and 480.2]
483	Failure to File Penalties – Penalty Abatement <ul style="list-style-type: none"> • COS §483(a) and (b) [Penalties related to §482(a)] • LEOP COS §483(c) [Penalties related to §482(b)]

BACKGROUND

Related Legislation. For prior years, the table below summarizes legislation proposed but not enacted to redefine change in ownership for legal entities and related measures.

Year	Bill	Summary
2013	AB 188 (Ammiano)	Change in Ownership Definitions. Substantively the same as this bill as introduced.
2012	AB 2014 (Ammiano)	Change in Ownership: Legal Entity Task Force. Convene a task force to update the work done by the 1979 task force.
2011	AB 448 (Ammiano)	Change in Ownership Definitions. Substantively the same as this bill as introduced.
2010	AB 2492 (Ammiano) – As Amended 5/18/10	Change in Ownership Definitions. Substantively the same as this bill as introduced.
2010	AB 2492 (Ammiano) – As Amended 4/8/10	Change in Ownership Definitions. Reassess property owned by publicly traded companies once every three years (rebuttable presumption). Property owned by other types of legal entities reassessed to current market value in proportion to the percentage of ownership interests in the legal entity transferred.
2008	AB 2461 (Davis)	Split Roll – Revenue Estimate. Require the BOE to study the revenue generated if nonresidential commercial property, as defined, is reassessed at its fair market value.
2005	SB 17(Escutia) -As Amended	Change in Ownership Definitions. Provides that a change in ownership occurs when more than 50% of the ownership interests in a legal entity (excluding publicly traded companies) are transferred to one or more persons or entities during a calendar year.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Year	Bill	Summary
2005	SB 17 (Escutia) - As Introduced 12/06/04	Change in Ownership Definitions. Reassess property owned by publicly traded companies once every three years (rebuttable presumption). Property owned by other types of legal entities reassessed to current market value in proportion to the percentage of ownership interests in the legal entity transferred.
2003	SB 17(Escutia)	Change in Ownership Definitions. Redefine change in ownership for nonresidential commercial and industrial property. (Legislative intent)
2003	ACA 16 (Hancock)	Annual Reassessment. Annual reassessment of nonresidential, nonagricultural property.
2003	SBx1 3 (Escutia)	Change in Ownership Definitions. Redefine change in ownership for nonresidential commercial and industrial property. (Legislative intent)
2002	SB 1662 (Peace)	Change in Ownership Definitions. Reassess nonresidential property when cumulatively more than 50% of the ownership has been transferred. Broaden the state and local sales and use tax base and reduce both the state and local sales and use tax rate. (Legislative intent)
2001	AB 1013 (Leonard)	Change in Ownership Definitions. Reassess property owned by a legal entity when more than 50% of the ownership shares transfer.
2000	AB 2288 (Dutra)	Change in Ownership Definitions. Reassess property owned by legal entity once every three years - Rebuttable presumption of change in ownership. Possible income tax credit to homeowners based on fair market value of homes from additional revenue. Reduce the sales and use tax rate by 0.25%.
1991	SB 82 (Kopp)	Change in Ownership Definitions. Reassess legal entities when cumulatively more than 50% of the ownership has been transferred.

Initiatives. Various initiatives to change the assessment of different property types have been pursued.

Year	Result	Summary
2009	Dropped	Split Tax Rate. Increase extra .55% for nonresidential real property excluding commercial agricultural property. Homeowners' Exemption. Increase to \$14,000 Business Personal Property. Exempt first \$1,000,000 in value from assessment. (Submitted by Roberta B. Johansen and Karen Getman)
2009	Dropped	Periodic Reappraisal. Reassess nonresidential real property excluding commercial agricultural property once every three years. Homeowners' Exemption. Increase to \$14,000 Business Personal Property. Exempt first \$1,000,000 in value from assessment. (Submitted by Roberta B. Johansen and Karen Getman)
2005	Dropped	Annual Reassessment. In part, require annual reassessment of all nonresidential real property excluding property used for commercial agricultural production. (Submitted by Roberta B. Johansen and James C. Harrison)
2005	Dropped	Split Tax Rate. Increase the tax rate on commercial real property except commercial residential rental property by either .30% or .50%. (Submitted by Roberta B. Johansen and James C. Harrison)
2005	Dropped	Split Tax Rate. In part, increase the maximum tax rate from 1% to 3% on nonresidential property; counties set the actual rate at no less than 2%. Limits the 1% tax rate on residential property to the first \$2 million. (Submitted by K. Heredia)
2005	Dropped	Annual Reassessment. Annually reassess nonresidential real property excluding property used for commercial agricultural production and personal property exemption of first \$500,000. (Submitted by Lenny Goldberg)
2005	Dropped	Annual Reassessment. Annually reassess nonresidential real property excluding property used for commercial agricultural production and personal property exemption of first \$500,000. (Submitted by Wayne Ordos)
2004	Signatures Collected & Initiative Dropped	Split Tax Rate. Increase tax rate to 1.5% for nonresidential real property excluding property used for commercial agricultural production. Proponent: California Teachers Association & Rob Reiner

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Year	Result	Summary
1992 Prop. 167	Failed 41.16% - 58.84%.	Change in Ownership Definitions. Addressed a number of tax related items, including a provision to modify the change in ownership definitions related to legal entities. Proponent: California Tax Reform Association

Legislation to strengthen legal entity change in ownership reporting and discovery includes:

SB 507 (DeSaulnier) Stats. 2011, Chapter 708. This California Assessors' Association sponsored bill increased from 45 to 90 days a legal entity's deadline to report a change in ownership or change in control to the BOE.

SB 816 (Ducheny) Stats. 2009, Chapter 622 This California Assessors' Association sponsored bill established penalties in Section 482 when a legal entity does not self-report a change in control or change in ownership under Section 64(c) or (d) to the BOE within 45 days of the event (subsequently changed to 90 days beginning 1/1/12). §§480.1, 480.2, and 482

It also eliminated automatic penalty extinguishment when a legal entity fails to file a LEOP COS after the first written request, but files within 60 days after a second request. §§482 and 483

SB 17 (Escutia – 2005) and SB 17 (Escutia – 2003) Among its provisions, these bills would have required legal entities to provide information, records, and documents necessary to ascertain if the legal entity has undergone a change in control or change in ownership under Section 64(c) or (d) upon the written request of the BOE or the assessor. Another provision allowed the BOE or the assessor to issue subpoenas for the attendance of witnesses or the production of information or records, if any person fails to provide required information or records for the purpose of securing change in ownership information.

COMMENTS

- Sponsor and Purpose.** The authors are sponsoring this bill to trigger more frequent reassessments of property owned by legal entities.
- The July 2, 2014 amendments** (1) eliminate the 36-month limitation making the 90% or more transfer of ownership interest threshold open-ended, (2) include direct and indirect transfers and address indirect ownership, (3) specify the reassessment date, (4) clarify that the BOE is to report on the revenue, rather than economic, impact, and (5) make technical amendments noted in the prior BOE analysis. **The May 28, 2014 amendments** (1) eliminated legal entity ownership interest deed recordation, (2) eliminated reporting each ownership interest transfer to BOE, (3) excluded publicly traded entities from the bill's application, (4) reduced the penalty for failure to report from 20% to 15%, and (5) require a BOE report by 2020.
- Legislative Findings and Declarations.** Includes an uncodified Legislative intent statement providing:
 - The Legislature finds and declares all of the following:
 - The system for determining a change in ownership for the purpose of assessment of commercial property is complex and difficult to administer.
 - Property ownership may include complex legal maneuvers and methods of dividing up ownership when changes of ownership actually occur.
 - There are circumstances in which changes of ownership have legally taken place that may not be known to the assessor because they are deliberately obscured, for

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

example, if the property is kept in the name of the old property owner even when a company is purchased.

(4) Deeds are filed that describe ownership patterns of such complexity that it is difficult for the legal powers of the counties, and the enforcement powers of the assessor, to be exercised.

(5) Transactions occur that should be identified as changes of ownership, for example, a 90% or more purchase of a company, that are not reassessed because of the division of ownership shares.

(b) Therefore, it is the intent of the Legislature to provide all of the following:

(1) Greater clarity with regard to those circumstances in which a change in ownership has occurred.

(2) Greater transparency in ownership patterns with respect to the filing of deeds and with respect to other real property and financial transactions.

(3) Improved reporting and stronger enforcement.

(c) It is further the intent of the Legislature that changes in ownership in which 90% or more of the ownership of a business, whether through mergers, private equity buyouts, transfer of ownership from one financial institution to another, transfers of shares of limited liability companies or trusts, transfers of partnership shares, or other changes by which 90% or more is transferred shall constitute a change of ownership subject to reassessment.

4. Under current change in ownership definitions, when companies (i.e., legal entities) are purchased or otherwise acquired, whether their real property is reassessed to current market value generally depends on whether there is a change in control.

Scenario 1 (Control): If **one** legal entity or person buys 100% of the ownership interests in another legal entity, then absent an exclusion, the law requires a **reassessment** of all the real property owned by the acquired legal entity. Since the acquiring legal entity or person obtains more than 50% of the ownership interest in the acquired legal entity under Section 64(c), this is a “change in control.”

Scenario 2 (No Control): If three **different** legal entities or persons buy 100% of the ownership interests in that same legal entity in equal shares, there is **no reassessment**. In this scenario, each new buyer only has a 33 1/3% ownership interest in the acquired legal entity and no one entity or person has control.

In both scenarios, the acquired legal entity has entirely new owners, but only Scenario 1 results in reassessment.

Date	Transaction	Reassessment
5/1/14	<p>Scenario 1</p> <p>Established Company (EC) buys 100% of the ownership interests in Startup Company (SC)</p> <p>SC owns 5 properties in various locations in California</p> <p>SC purchased properties in 2000, 2002, 2005, 2008, 2012</p>	<p>EC Obtains Control of SC</p> <p>Reassess all 5 properties to market value on May 1, 2014.</p>

Date	Transaction	Reassessment
5/1/14	<p>Scenario 2</p> <p>Three Venture Capitalists (VC₁, VC₂, VC₃) buy 100% of the ownership interests in SC in equal shares.</p>	<p>Neither VC₁, VC₂, or VC₃ singularly control SC: each have 33 1/3%</p> <p>No Reassessment of any property owned by SC</p> <p>The 5 properties retain the assessed value established at the time acquired by SC</p>

5. **New Change in Ownership Trigger Point.** This bill adds a new reassessment trigger event with respect to transfers of ownership interests in legal entities. Properties will be reassessed whenever **90%** or more of a legal entity's ownership interests are cumulatively transferred. Currently, only if a transfer of ownership interests causes a "change in control" of the legal entity (i.e., pushing one person (or legal entity) up and over the 50% ownership interest threshold) is the property owned by that legal entity reassessed to its current value. This bill changes the law to require reassessment of Startup Company's five properties in the Scenario 2 transaction discussed above.
6. **Threshold Test: Look-back to January 1, 2015.** The 90% cumulative transfer threshold would be open ended on a going-forward basis with a back stop date of January 1, 2015.
7. **This bill attempts to treat the transfer of ownership interests in legal entities more like the transfer of real property interests.** Any transfer of **real property interests** results in a change in ownership, absent an applicable exclusion, while transfers of **ownership interests in a legal entity** do not result in a change in ownership of property owned by the legal entity unless Section 64(c)(1) or (d) are triggered. The bill's proponents claim that the current system is inequitable. The following illustrates the disparate treatment:
 - **Transfer of Real Property Interest.** Four individuals each own a 25% interest in a property. Each sale of an individual's 25% interest in the property triggers a 25% reassessment. (ABCD to EFGH)
 - **Transfer of Ownership Interest in Legal Entity.** If the same property is *owned by a legal entity* in which the same four individuals each own a 25% interest, a sale of an individual's 25% interest in the legal entity will not cause a reassessment of the property owned by the legal entity. This is true even if there is a complete turnover of ownership interests in a single event. Only if one person obtains control (defined as ownership interests of more than 50%) of the legal entity is reassessment triggered. (ABCD to EFGH)

This bill provides that whenever 90% or more of the ownership interests in the legal entity cumulatively transfer in one or more transactions that occur after January 1, 2015, a change in ownership of the legal entity will occur, resulting in reassessment of property owned by it.

This disparate treatment is illustrated in columns 4 & 5 of the following table. Column 6 shows this bill's reassessment consequences when legal entity ownership interest transfers. (Note: Only the first and last transfers that take place on January 1, 2015, and January 30, 2020, respectively, reflect the changes made by this bill. The other transfer examples reflect existing law.)

Progression of Transactions	Transfer Date	Owners After Transfer	Percent Reassessed if <u>Real Property Interests</u> Transfer Under Current Law	Percent Reassessed if <u>Legal Entity Ownership Interests</u> Transfer Under Current Law	Percent Reassessed if <u>Legal Entity Ownership Interests</u> Transfer Under AB 2372
A sells 25% to E B sells 25% to F C sells 25% to G D sells 25% to H	01/01/15	EFGH	100%	0%	100% ¹
E sells 25% to I	04/05/16	FGHI	25%	0%	
F buys G's 25% F buys H's 25%	09/10/17	FI 75%/25%	50%	100% ²	
F buys I's 25%	10/15/18	F	25%	0% ³	
F sells 50% to J	12/30/19	FJ	50%	0% ⁴	
F sells 50% to K	01/30/20	JK	50%	0%	100% ⁵

¹ **All New Owners – But No One in Control.** Transfer of 100% of ownership interests. This bill's new change in ownership trigger point results in reassessment. Property reassessed to its market value on January 1, 2015.

² **Change in Control.** On September 10, 2017, F acquires "control" of the legal entity; F now owns 75% of the legal entity's ownership interests. Current law requires a 100% reassessment of the property to its value on September, 10, 2017.

³ **No Change in Control.** F owns 100% of the legal entity as of October 15, 2018. But, since F previously obtained control of the legal entity on September 10, 2017, No reassessment under current law.

⁴ **Loss of Control.** F owns 50% and J owns 50%. No one controls the legal entity. While F has lost control, no one gained control. No reassessment.

⁵ **90% or More Cumulative Transfer.** 100% of the ownership interests are cumulatively transferred. Property reassessed to its value on January 30, 2020.

8. **Is the transfer of ownership interests in legal entities without reassessment consequences unintentional?** The Proposition 13 Task Force debated the issue of how to treat sales and transfers of legal entity ownership interests. The Task Force understood the current definitions would result in this disparate treatment. The Task Force recognized the potential long term effect of the original definitions noting "(t)he Task Force admits that some of its own recommendations, such as those regarding legal entities, while the best of a seemingly 'no-win' choice of options and adopted to mitigate administrative difficulties, may, in the long run, further exacerbate this [tax burden] shift to residential property because it will result in fewer potential commercial and industrial property transfers being recognized for reappraisal purposes." Consequently, the Task

Force proposed that the Legislature later consider a constitutional change to periodically reappraise commercial and industrial property. In 2012, Assembly Member Ammiano introduced unsuccessful legislation (AB 2014) to create a new task force to study this issue. After nearly 35 years, this bill seeks to add a new definition to those initially created to cause more frequent reassessment when property is owned by a legal entity.

9. **This bill requires assessors to reassess property upon various events that may be excluded from reassessment under current law.** For example, under this bill reassessment may be required in the following situations where a company or business has real estate holdings:
 - A married couple buys a company with real estate holdings. (Under current law, ownership of the company is considered held 50/50 with neither spouse in control. Thus, this transfer does not meet the “change in control” test.)
 - A company’s current managers or employees buy the company from the retiring owners and no one person acquires control.
 - Children inherit their parents’ company with real estate holdings and no one child acquires control.
 - A group of people inherit a company and no one person acquires control.
 - A business (with no one in control) buys another competitor’s business.
 - A business (with no one in control) buys a supplier.
10. **As introduced, this bill did not address ownership interests in legal entities that are transferred indirectly to another legal entity or person.** With sufficient planning and legal advice, it might have been possible to structure transactions that transfer property via a legal entity to new owners indirectly using multiple tiers of legal entities and minimize or preclude reassessment under the new change in ownership trigger. As such, the definition was amended to include indirect ownership transfers and to count indirect ownership interests proportionately.
11. **This bill affects all types of real property owned by a legal entity.** This bill does not differentiate between residential and commercial property. All types of real property owned by a legal entity (partnerships, limited liability companies, corporations, etc.) are subject to the new triggering event. Thus, this bill could impact single family homes, multi-family properties (such as apartments, duplexes and mobilehome parks), agricultural property, family farms,⁶ and small businesses.
12. **As introduced, the bill did not specify whether or not the 90% cumulative count should restart after a change in control of a legal entity.** To address this uncertainty, subdivision (g) was added to Section 64 to provide that a change in ownership of real property owned by a legal entity under any provision of Section 64 restarts the cumulating of transferred ownership interests for purposes of determining whether another change in ownership of that real property occurs under Section 64. Currently Section 64(c)(1)(B)(ii)(V) specifies that whenever a change in ownership is triggered under Section 64(c)(1)(B), those shares shall not be counted again. However, it does not specify that upon a change in control [Section 64(c)(1)(A)], those shares are not counted again to determine whether a change in ownership occurred under Section 64(c)(1)(B).

⁶ The parent-child change in ownership exclusion does not apply to transfers of ownership interests in legal entities, except to the extent the [uncodified note](#) of Section 63.1 is followed [Section 2 of Stats. 1987, Ch. 48 (AB 47), as amended by Section 6 of Stats. 2006, Ch. 224 (SB 1607)].

For example, A owns 100% of LLC and A transfers 75% to B in Year 1 and 25% to C in Year 3. In Year 1, a change in control of LLC occurs under Section 64(c)(1)(A) and LLC's property is reassessed. The question is whether the 75% transfer also counts toward the 90% count in which case the Year 3 transfer will cause a change in ownership under this bill, or whether after the change in control, the 90% count restarts to zero such that the Year 3 transfer does not cause a change in ownership under this bill. In this example, the addition of subdivision (g) means the 90% count restarts to zero after the 75% transfer triggers reassessment under Section 64(c)(1)(A).

13. **Williamson Act property.** In practical application, Williamson Act property and other property under contract and eligible for special assessment provisions (such as the Mills Act for historical property) will not be impacted *provided* the property remains under contract. The law requires these properties to be assessed at the *lowest* of three specified values. While a new base year value would be reset if a change in ownership occurs under the new trigger, this value would likely be greater and will not become the basis of assessed value.
14. **BOE Implementation Report to Legislature.** The bill requires the BOE to report to the Legislature, no later than January 1, 2020, a report on the implementation of this new reassessment trigger that includes its revenue impacts. The BOE can report this bill's revenue impact by requiring assessors to track and report the necessary data. As introduced, an economic impact report was required.
15. **What is a "split roll?"** Typically, the term "split roll" means taxing various property types (e.g., residential vs. commercial) according to a different tax rate or value standard. In the context of reassessment of legal entity owned property, some use the term to reference modifying the change in ownership provisions related to legal entity ownership interests to trigger more frequent reassessment, such as this bill proposes. A true "split roll" is not possible without a constitutional amendment.
16. **Modifying "Change in Ownership" provisions.** While Proposition 13 amended the constitution to provide that a "change in ownership" triggers reassessment, it did not define the phrase. Statutory language defines the term and specifies transfers included or excluded from a change in ownership. Thus, statutory amendments modifying the original statutory definitions are permissible.

COST ESTIMATE

The BOE's cost to administer this bill is estimated to be \$686,000 in fiscal year 2014-15 and \$917,000 annually thereafter. Legal entity changes in ownership are complicated. This bill represents the first substantive change in legal entity change in ownership law since the original definitions were first crafted. This bill requires changes to regulations, handbooks, taxpayer guidance materials, FAQs, and instructions. Furthermore, annotated letters on legal entity change in ownership law currently relied upon will no longer be relevant. Substantial time and resources to research, study, and answer these new issues will be necessary to implement this bill.

REVENUE ESTIMATE

The bill increases the reassessment of real property owned by legal entities. The result is an increase in assessed value and an increase in property tax revenue.

Estimating the revenue increase with any degree of certainty is difficult. We do not know the number of these transactions in California. We neither know the current assessed value of real property owned by legal entities, nor its current market value. We can, however, make

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

some assumptions concerning the amount of property under consideration. The value of 2012-13 locally assessed real property was \$4.2 trillion. Based on information received from property tax roll files in a small sample of counties, we estimate the portion of legal entity assessed value at 23%, or \$956 billion.

Each year, the BOE conducts a study to determine the effective assessment level (i.e., the percentage difference between assessed value and market value) for commercial/industrial property in order to determine the assessment level for rail transportation property (the 4R Ratio). The latest study, based on the 2012-13 assessment roll, finds the effective assessment level is about 80%. Applying this ratio to the estimated legal entity assessed value, we estimate the current legal entity market value to be:

\$956 billion / 80%, or \$1.2 trillion.

We cannot predict the annual reassessments of legal entity property. Change in ownership statements submitted to the BOE do not capture the number of past transactions. The data we do collect suggests the proportion of assessed value subject to reassessment is very small. Assuming 3% of legal entity properties are subject to reassessment to current market value each year, the revenue impact at the basic 1 % property tax rate is:

Estimated	Estimated	Estimated	Estimated	Estimated
Legal Entity Assessed Value	4R Ratio	Legal Entity Market Value	Increase in Assessed Value	Revenue Gain
\$956 billion	80%	\$1.2 trillion	\$244 billion	\$73 million

This bill would also increase the penalty for failure to file legal entity change in control statements from 10% to 15% of taxes due. According to the BOE's County-Assessed Properties Division, transactions subject to this penalty are minimal, historically not more than 10% of all filings. Assuming the average assessed value for property owned by legal entities is \$300,000, we estimate the revenue impact of increasing the failure to file penalty to be less than \$1 million annually. This amount may decrease over time as the increased penalty becomes a deterrent to late filing.

REVENUE SUMMARY

Based on the preceding assumptions, the annual revenue gain could amount to about \$73 million.

Qualifying Remarks. The revenue estimate is based on limited data. It gives an indication of the order of magnitude of the revenue impact. The impact will vary from year to year depending upon the number of annual transactions and the value of properties owned by a legal entity.

This revenue impact does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

Analysis prepared by: Rose Marie Kinnee 916-445-6777 07/24/14

Revenue estimate by: Chris Butler 916-445-0840

Contact: Michele Pielsticker 916-322-2376

ls 2372ab070214rmk.docx

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.